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PP RUEHCN RUEHGH RUEHVC
DE RUEHBJ #5248/01 2220607
ZNR UUUUU ZZH
P 100607Z AUG 07
FM AMEMBASSY BEIJING
TO RUEHC/SECSTATE WASHDC PRIORITY 0650
RUCPDO/USDOC WASHDC PRIORITY
INFO RUEHOO/CHINA POSTS COLLECTIVE
RUEHGV/USMISSION GENEVA 1917
RHEHNSC/NSC WASHDC
RUEHJA/AMEMBASSY JAKARTA 1887
RUEHKL/AMEMBASSY KUALA LUMPUR 2506
RUEHGP/AMEMBASSY SINGAPORE 9159
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RUEHML/AMEMBASSY MANILA 9003
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RUEHMS/AMEMBASSY MUSCAT 0025
RUEHDO/AMEMBASSY DOHA 0193

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USDOC FOR DAS KASOFF AND ITA/MAC/AP/MCQUEEN
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GENEVA PASS USTR

E.O. 12958: N/A

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SUBJECT: CHINA CONTINUES FTA EXPANSION IN 2007

REFS: A) BEIJING 0609 B) BEIJING 09501(06)

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1. (SBU) Summary: While consistently professing support for the Doha Round of WTO negotiations China is moving forward on an ever increasing number of Free Trade Agreements (FTAs) in 2007, according to MOFCOM Director Zhu Guangyao. Previously concluded Trade in Goods Agreements are being followed by Services and Investment negotiations with ASEAN, Chile and Pakistan. In order to gain experience with Europe, China is exploring FTAs with Norway, Iceland, and Switzerland. Difficulties in negotiating trade agreements remain and the larger and more complicated

FTA with Australia, combining goods and services, appears stalled with estimates for completion now ranging from 2-3 years. China has launched a FTA feasibility study with Costa Rica and has accelerated the FTA process with South Korea. It has made approaches to Egypt and the South Africa Customs Union (SACU), but the response has been tepid. Talks with India and the Gulf Cooperation Council are proceeding slowly. Paragraphs 6-17 summarize the individual status of China's FTAs. End Summary.

Foreign Interest in FTAs with China Is Strong

¶2. (SBU) When Prime Minister Wen Jiabao and other senior leaders travel abroad, the possibility of concluding an FTA is often the first topic their foreign interlocutors raise, Zhu said. Leadership understands how important the issue is to other countries. After the 17th Party Congress, there will be "some adjustment of the economic ministries." Zhu indicated that some had advocated creation of a specialized trade organization along the lines of the United States Trade Representative, but said such a major initiative would have to come from the State Council.

Assessing the Economic Impact of FTAs on China

¶3. (SBU) Due to staffing shortages, MOFCOM has not completed any comprehensive studies on the economic/commercial impact of FTAs. China's trade with Chile, however, increased 80 percent in the three months since their FTA was completed, according to Zhu. Chinese

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small- and medium- enterprises do not feel particularly threatened by FTA's, Zhu stated. ASEAN businesses are benefiting more than Chinese companies as the inland provinces of Yunnan and Guangxi are not applying for trade certificates. Zhu said MOFCOM will seek to publicize the value of the FTAs in China. Meanwhile MOFCOM Division Five is conducting a study on the potential impact of a China-Korea FTA.

The Two Red Lines: Market Economy Status and One China

¶4. (SBU) Zhu was clear that the two non-negotiable preconditions for an FTA are diplomatic relations with the PRC and recognition of China's status as a Market Economy. Zhu noted the Swaziland is still "under the hand" of Taiwan and "diplomatic difficulties" exist with Paraguay. Zhu said Costa Rica insisted on China's agreeing to begin FTA negotiations in return for switching recognition from Taiwan to the PRC. At the time of the switch, Taiwan was already trying to negotiate an FTA with Costa Rica, Zhu noted.

Other Criteria - Larger the better, but all welcome

¶5. (SBU) China prefers FTA partners that are large with economic and trade structures that complement China's, Zhu said. China prefers to negotiate with smaller economies as a group (e.g., ASEAN). While some countries prefer Partial Trade Agreements (PTAs) they are not a good option for China since they have limited tariff line reductions and focus only on goods. (Embassy Comment: In practice, however, China has been flexible. We are unaware of an example of China's refusing to negotiate an FTA with a country because its economy is too small. End Comment.)

East and Southeast Asia

¶6. (SBU) ASEAN - The FTA in Services will enter into force in July 2007. China will open up new markets to ASEAN

countries in 26 branches of 5 service areas which include construction, environmental protection, transportation,

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sports and commerce. ASEAN agreed to open their markets to China in finance, telecommunication, education, tourism, construction and medical treatment, according to a MOFCOM press release. The Trade in Services Agreement marks the second phase of China-ASEAN trade negotiations. In 2004 a Trade in Goods Agreement was completed covering 7,000 products which was implemented in 2005. Full FTA implementation is expected by 2010 (Reftel B).

17. (SBU) South Korea - MOFCOM Deputy Director Ms. Wang confirmed to Econoffs that China and South Korea have agreed to "speed up" the research phase of FTA talks. Ms. Wang said that this decision was spurred by news of the conclusion of United States - South Korea FTA negotiations. Wang pointed out that China's FTA negotiations with South Korea are being handled by a DG, which indicates the importance MOFCOM attaches to this economic relationship.

18. (SBU) Australia - Zhu characterized this FTA as the hardest to negotiate. Big differences still exist regarding agriculture, textiles and electrical machinery. Both sides keep in touch but no new recent concessions have been made, Zhu commented. The last round was held in May while they are supposed to have one round every two months. China is facing a great challenge from the Ministry of Agriculture which is trying to protect Chinese farmers (e.g. rice in the east and central regions, dairy, wheat, beef and mutton in the north.) Australia's competitive advantage is in agriculture, he emphasized.

19. (SBU) New Zealand - According to the New Zealand Embassy in Beijing, talks are ongoing but agricultural issues have been hard to resolve. (Note: New Zealand is also seeking a comprehensive FTA which includes both goods and services. End note.) New Zealand lacks the negotiating leverage of larger economies and will conclude a deal at some point, the Embassy contact said.

Latin America

10. (SBU) Costa Rica and China will conduct a feasibility study this year. Mexico has proposed a Preferred Trading Agreement (PTA) but China is only interested in an FTA. No

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consensus between the two has been reached. Paraguay still has diplomatic relations with Taiwan so there are "diplomatic difficulties", Zhu noted. China and Peru have initiated a joint feasibility study.

11. (SBU) The first round of services talks with Chile were held in January, 2007 and began only four months after the goods agreement was implemented. It included discussion on banking, overseas labor, education, construction, tourism, water transportation, health, telecommunication, Chinese medicine and energy resources. Both parties also discussed current laws and regulations on investment. MOFCOM Director Zhu noted that there have been many complaints from Chile regarding tropical fruits. He did not elaborate.

South Asia - Pakistan On, India Stalled?

12. (SBU) Pakistan - Discussions on Trade in Services and Investment is ongoing according to Zhu. A Free Trade Agreement on Goods was signed in November, 2006. All tariff reductions from the early harvest agreement remain in place. The Phase I agreement, which remains in force

for five years, eliminates customs duties on 35.5 percent of Chinese goods and 35.6 percent of Pakistani goods at the eight digit tariff code level over three years. Both countries made no concessions on 15 percent of goods for Phase I. Phase II of the agreement seeks to "eliminate the tariffs of no less than 90% of products, both in terms of tariff lines and trade volume within a reasonable period of time on the basis of friendly consultation and accommodation of the concerns of both Parties."

¶13. (SBU) India - MOFCOM indicated that a joint study is ongoing. The Indian Embassy in Beijing indicated at one point that an FTA was highly unlikely due to the overlap in competitive industries in both countries.

Gulf Cooperation Council (GCC) - Slow Going

¶14. (SBU) Director Zhu said that four rounds have been completed but are proving difficult. The main GCC

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interlocutor is the Director General from the GCC Secretariat which is usually a Saudi. The Saudis, Zhu

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lamented, have many holidays and only work four hours per day. Each round of negotiations is one to two days.

Europe - Small Steps First

¶15. (SBU) By negotiating with smaller European countries such as Iceland, China hopes to gain experience and insights that will help with larger European economies, Zhu said. The China-Iceland joint feasibility study has been completed, and FTA negotiations have formally begun with Norway, Switzerland and Iceland which seem to be competing with each other, he noted. Iceland is expected to finish negotiations by the end of 2007 according to the Norwegian Minister Counselor for Economic Affairs.

¶16. (SBU) A China-Norway feasibility study is expected to be finished by the end of 2007, with the conclusion of FTA negotiations one year later. The Norwegian Minister Counselor observed that China wants to start with a bilateral agreement. He said China seems uncomfortable with the process and would rather take a step by step approach while Norway wants a comprehensive agreement. Norway's main interest is in fishery products with their main competition being Chile which, due to the China/Chile FTA, now has a 10 percent price advantage. The volume of Norwegian fish products is not large at the moment and mainly consists of salmon exports to China. Of the approximately USD 2 billion in total exports, 25 percent are fishery products. Energy is not a main interest because Norway sells its oil and gas on the spot market and has no need for long-term contracts, he added. Services interests include shipping, insurance and telecom. China's main interests are access to the Norwegian market for agricultural products, building China's trade reputation, and financial access, the Norwegian Minister Counselor said.

Africa - SACU, Egypt, Nigeria

¶17. (SBU) Zhu said China had proposed an FTA with the Southern African Customs Union (SACU -- South Africa,

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Botswana, Lesotho, Namibia and Swaziland), but SACU has not replied yet and seems hesitant. Zhu noted that Swaziland is still "under the hand" of Taiwan. At one time, Egypt had proposed FTA talks, but then backed down when domestic

businesses expressed reservations. Nigeria prefers a TA,
Zhu added.

Comment

¶18. (SBU) In practice, China seems willing to consider FTA negotiations with any country that recognizes its WTO status as a Market Economy and does not recognize Taiwan. On that basis, it has made progress over the past year in enlisting FTA partners among the world's small and medium-sized economies. To expand the FTAs to encompass larger economies like Australia and South Korea it will have to revamp staffing at MOFCOM and confront concerted opposition from domestic economic interests. End Comment.

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